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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

BANCO ESPANOL DE CREDITO, BANESTO BANKING CORPORATION, BANCO TOTTA & ACORES, GIROZENTRALE UND BANK DER OSTERREICHISCHEN SPARKASSEN AG, HARMONY GOLD LTD. HONG KONG, INTERNATIONAL COMMERCIAL BANK OF CHINA, MONROE BANK & TRUST, PHELPS DODGE CORPORATION, and STATE STREET BANK & TRUST COMPANY, as Master Trustee for the Retirement Plans of Atlantic Richfield Company and certain of its subsidiaries,

Petitioners,

—against—

SECURITY PACIFIC NATIONAL BANK and SECURITY PACIFIC MERCHANT BANK,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

SUPPLEMENTAL BRIEF FOR PETITIONERS

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SUPPLEMENTAL BRIEF FOR PETITIONERS

This supplemental brief is respectfully submitted by petitioners pursuant to Rule 15.7 of the Rules of this Court in response to the new matter raised in the brief of the United States as *amicus curiae*, filed on June 3, 1993.

Argument

On January 19, 1993, this Court invited the Solicitor General to file a brief in this case expressing the views of the United States. Although the Solicitor General's brief ultimately recommends against the granting of the writ, the contents of the brief paradoxically underscore the pressing importance of the issue presented here and the grievous error of the majority opinion below. More importantly, the Solicitor General's argument against the granting of the writ relies heavily on a newly-presented possibility of action by "bank regulators" to address the problems caused by that opinion. But that argument—supported only by vague references to private conversations between the Solicitor General and unspecified "regulators"—is entirely undermined by the complete inactivity by those regulators to date, and the Solicitor General's erroneous description of current bank regulations in this area.

I.

THE SOLICITOR GENERAL'S BRIEF CONFIRMS WHY THE WRIT *SHOULD BE* GRANTED: THE OPINION BELOW IS ERRONEOUS AND THE MARKET AFFECTED IS OF ENORMOUS IMPORTANCE.

At the outset, we stress that the bulk of the Solicitor General's brief simply confirms the positions we took in our petition. On the merits of the decision below, the Solicitor General unequivocally agrees with us and with the Securities

and Exchange Commission, which forcefully asserted its views in an *amicus* brief requested (and then ignored) by the Second Circuit and then again in urging rehearing: The Solicitor General declares the opinion of the panel majority to be "open to serious question" (S.G. Br. 9), "err[oneous]" (*id.* 9, 12), "flawed" (*id.* 10, 11, 14), and reflecting a fundamental "misunderst[anding]" of this Court's ruling in *Reves v. Ernst & Young*, 494 U.S. 56 (1990) (*id.* 13).

Moreover, tucked discreetly in a footnote, the Solicitor General acknowledges that the distorting effect of the majority opinion predicted in our petition has already begun. The first district court decision applying the Second Circuit's opinion (decided after the filing of the petition), far from vindicating the Solicitor General's confidence that the damage from the opinion below will be contained, *extends* the reasoning of the majority opinion to "mortgages and mortgage participations purchased by unsophisticated members of the general public who lacked full access to credit information." *Id.* at 11 n.5, citing *Pollack v. Laidlaw Holdings, Inc.*, 1993 U.S. Dist. LEXIS 459 (S.D.N.Y. Jan. 21, 1993).

More importantly—from the standpoint of the pending petition for certiorari—the Solicitor General's description of the importance of the affected market makes clear both the economic significance of the instruments exempted below from regulation, and the crucial need of investors in such instruments for the protection of the securities laws. The Solicitor General notes the increasingly critical role played by loan notes as a source of capital (S.G. Br. 16-17 & n.7), and emphasizes the rapid evolution of financial practices in this area (*id.* 17-18). Further, the Solicitor General approvingly cites both the financial institutions themselves and academic commentators as evidence that the evolution is in a disturbing direction: The loan note business is growing; it has evolved toward shorter-term instruments, sold to a broader public, by more aggressive marketing; and the instruments sold are increasingly *non*-investment grade, with little publicly-available information

about the issuers. *Id.*, citing the brief *amicus curiae* of the New York Clearing House Association below, and Note, *Bank Loans as Securities*, 40 U.C.L.A. L. Rev. 799 (1993).

Thus, the Solicitor General's brief confirms all three points central to our petition for granting the writ: the Second Circuit's opinion is wrong; it is wrong in a way that will distort the future path of legal development, as well as of financial practice; and it is wrong about an important, growing, and fast-evolving sector of the financial markets.

II.

THE SOLICITOR GENERAL'S ARGUMENTS AGAINST CERTIORARI ARE INACCURATE AND UNPERSUASIVE.

Having shown impressively the pervasive error of the opinion below and the damaging consequences to the law and the financial markets of leaving that error uncorrected, the Solicitor General nevertheless recommends that certiorari not be granted because institutions other than this Court may eventually ride to the rescue. The hopes held out by the Solicitor General are singularly unpersuasive, and in at least one critical area, based on inaccurate information directly contradicted by official bank regulatory policy.

1. The Solicitor General's most significant and surprising effort at reassurance is the suggestion that unidentified "federal bank regulatory agencies" are purportedly "*considering* whether to provide further guidance to the banking industry on loan-participation programs." (S.G. Br. 17; emphasis added). This assertion—unsupported by reference to any indication of impending regulatory activity—is undermined by the total failure of those regulators ever to act in this area, and by the Solicitor General's erroneous description of the existing state of bank regulations.

First, the assertion that these unnamed regulators are contemplating "further" guidance rests on the Solicitor General's unsupported suggestion that bank regulators have interpreted existing regulations to protect purchasers of loan notes. (S.G. Br. 14). Acknowledging that the majority below erroneously relied on the Office of the Comptroller of the Currency's (OCC) Circular 181 as a factor reducing risk in the loan note market, the Solicitor General nevertheless asserts—without citation to any publicly-available source—that although the actual text of the Circular imposes requirements solely on national banks that *buy* loan participations (and does not address any other buyers, or national banks acting as *sellers*), the OCC "construes" the Circular to regulate *sales* activities of national banks selling loan notes as well. (S.G. Br. 14).

But the OCC's official position is directly contrary to its private "construction" of Circular 181 in conversations with the Solicitor General. As petitioners have noted again and again, the OCC's own interpretive materials are explicit that Circular 181 imposes *no* requirements of any kind on sellers, and certainly offers purchasers nothing in the way of "significant" protection, as required under *Reves*. *See, e.g.*, Letter of William B. Glidden, Assistant Director, OCC Legal Advisory Services Division, December 18, 1985, at 2. (A219-20).

Second, neither the bank regulators' record nor their position as reflected in the Solicitor General's brief inspires any confidence that bank regulators will act to protect loan note investors. Indeed, in the four years since the loan notes at issue were sold, bank regulators have taken no action at all despite the evidence persuasively presented by the Solicitor General that the loan note market has grown substantially in size while deteriorating in the credit quality of the notes issued and in the availability to the investing public of information about issuers. Most revealing is the Solicitor General's disclosure that bank regulators do not see the loan note market as requiring further regulatory attention (S.G. Br. 16), and appear to believe that the loan note market is so essential in enabling banks to com-

pete with sellers of commercial paper and other recognized securities that this Court dare not do anything that might affect it (*id.* 16 n.7). In this context, assurances privately given to the Solicitor General—plainly to deter intervention by this Court—that bank regulators are "considering" possible action (S.G. Br. 17) should be given no weight at all.

2. Stressing the absence of a circuit conflict (S.G. Br. 15-16), the Solicitor General suggests that other courts of appeals can be counted on to re-examine the Second Circuit's position (*id.* 18). But the notion that this Court should wait until other courts of appeals deal with this issue, while perhaps appealing on an academic level, ignores the practical realities of the financial markets. Those markets are, as the Solicitor General emphasizes, in a period of unrestrained development, particularly as regards the role of banks in fashioning and marketing investment instruments. This development will be accelerated even further with respect to loan notes, given the imprimatur here of the Second Circuit—the preeminent court of appeals for securities matters. Waiting for other cases turning on this issue to germinate and make their way through the federal system would abdicate this Court's role and ensure that, should a conflict eventually arise, this Court would be confronted with a choice between accepting a *fait accompli* based on settled reliance interests or correcting the Second Circuit's error at the cost of disturbing those expectations. Failure to grant review—particularly in light of the strong position taken by the Commission—risks making what the Solicitor General terms the erroneous and flawed opinion below the misguided law of the land.

3. Finally, the Solicitor General suggests at several points that the Second Circuit's short amendment to its opinion indicates that the court below, recognizing its error, already has limited—or may in the future limit—the broad reach of its opinion. (S.G. Br. 8-9, 11-12). But as we have pointed out (Pet. 12-13, 18), the panel's tautological emphasis that its decision rests on the particular facts of this case offers no comfort and

no guidance. At a minimum, the opinion below stands as clear authority that a loan note program conforming to the dangerous practices adopted by Security Pacific is not subject to the antifraud provisions of the securities laws—a clear invitation to the expanding loan note market to develop in this dubious direction. And as demonstrated by the one district court opinion to date to apply the opinion below, the Second Circuit's "limitation" of its holding has done nothing to prevent the majority opinion from standing as a beacon directing district courts in precisely the direction the Solicitor General assures us they should not—and will not—go. *See Pollack v. Laidlaw Holdings, Inc., supra.*

* * * * *

In effect, the Solicitor General's brief asserts that, if, as expected, the need for investor protection in the loan note markets continues to grow, then the need for this Court's intervention will "at some point" become more pressing. (S.G. Br. 17). The economic and jurisprudential importance of the opinion below, however, requires that the question whether loan notes are securities be addressed now. This Court should not be lulled into waiting for another day to give guidance to markets that believe they already have received an answer—an answer that the Solicitor General acknowledges is deeply erroneous.

CONCLUSION

The petition for certiorari should be granted.

Dated: June 7, 1993

Respectfully submitted,

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